LEOFF 1 Benefit Cap

Background

When first founded, LEOFF 1 had no benefit cap. With the passage of Chapter 120, laws of 1974, members' benefits were capped at 60% of final average salary. Those hired into LEOFF 1 positions on or after February 19, 1974 -- the effective date of the act -- are subject to the 60% cap; those hired prior to that date are not.

Of the total 8,054 LEOFF 1 retirees, 2,344 became members prior to February 19, 1974. Of those, 659 had a benefit that was greater than 60% of their final average salary.

As of the 2003 valuation the LEOFF 1 plan has 991 active members and 8,054 retirees. Of the remaining active members, 507 are subject to the 60% benefit cap.

Committee Activity

Presentation:
December 7, 2004 - Executive Committee

Recommendation to Legislature

None.

Staff Contact

Robert Wm. Baker, Senior Research Analyst
(360) 586-9237 – baker.robert@leg.wa.gov

LEOFF 1 Benefit Cap

(December 21, 2004)

Proposal

Remove the 60% cap on final average salary (FAS) used in calculating the retirement benefits of Law Enforcement Officer's and Fire Fighter's Plan 1 members.

Staff

Robert Wm. Baker, Senior Research Analyst
(360) 586-9237

Members Impacted

As of the 2003 valuation the LEOFF 1 plan has 991 active members and 8,054 retirees. Of the remaining active members, 507 are subject to the 60% benefit cap.

Current Situation

When first founded, LEOFF 1 had no benefit cap. With the passage of Chapter 120, laws of 1974, members' benefits were capped at 60% of final average salary. Those hired into LEOFF 1 positions on or after February 19, 1974 -- the effective date of the act -- are subject to the 60% cap; those hired prior to that date are not.

Of the total 8,054 LEOFF 1 retirees, 2,344 became members prior to February 19, 1974. Of those, 659 had a benefit that was greater than 60% of their final average salary.

The Public Employees' Retirement System (PERS) Plan 1 and the Teachers' Retirement System (TRS) Plan 1 both have provisions capping retirement benefits at 60% of average final compensation (AFC).

The Plans 2/3, including LEOFF 2, have no benefit cap, but they are age-based plans as opposed to service-based plans. The School Employees' Retirement System (SERS), PERS and TRS 2/3 require members to be age 65 in order to receive an unreduced defined benefit. LEOFF 2 requires members to be age 53 to receive an unreduced benefit compared to age 50 in LEOFF 1.

History

Two bills were introduced during the last legislative session related to the 60% cap in LEOFF 1. HB 2416 proposed raising the limit to 70% of FAS, and HB 2914 proposed eliminating the cap entirely; both bills received a hearing but neither moved from committee.

Policy Analysis

One of the general policies found in the funding chapter (RCW 41.45) is "Fund, to the extent feasible, benefit increases for all plan members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service." The average age of remaining active LEOFF 1 members is 54 years, and their average member service is 29.3 years. For a plan that wasn't fully funded, there would be scant time to contribute to a benefit increase for an active membership that is already, on average, retirement eligible. Because LEOFF 1 is in surplus status at this time, any benefit increase would draw on that surplus.

Another policy issue to consider is the inconsistent treatment of members within the same plan. While the provisional differences in LEOFF 1 and LEOFF 2 are typical of closed and open plans, it is rare, however, for such differences to be present within the same Washington State retirement plan.

The other policy concern would be leapfrogging. One of the common criticisms of the Plan 1 design is the 30-year cap or 60% cap; member's benefits are maximized at 30 years of service (2% × 30 years of service = 60% of AFC). Were the cap raised or eliminated in the LEOFF 1 plan, members of the Public Employee's Retirement System Plan 1 (PERS 1) and Teachers Retirement System Plan 1 (TRS 1) may request a similar benefit increase which would have a much higher cost.

Stakeholder Input

Richard Warbrouck
Retired Fire Fighters of Washington
See attached correspondence

Philip A. Talmadge
Talmadge Law Group PLLC
See attached correspondence

Executive Committee Recommendation

None.

Bill (Draft)

Bill Attached

Fiscal Note (Draft)

Fiscal note attached

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Office of
The State Actuary

Richard Warbrouck
President

Bob Burtch
Secretary

November 2, 2004

The Honorable Senator Karen Fraser
Chair, Select Committee on Pension Policy
PO Box 40422
Olympia, WA 98504-0422

The Honorable Representative Steve Conway
Vice Chair, Select Committee on Pension Policy
PO Box 40600
Olympia, WA 98504-0600

Mr. Matt Smith, State Actuary
Office of the State Actuary
PO Box 40814
Olympia, WA 98504-0914

Dear Senator Fraser, Representative Conway and Mr. Smith,

I want to thank you for your consideration of the LEOFF 1 issues that were on the Select Committee on Pension Policy October 18, 2004 meeting agenda.

We are opposed to the request to remove the 60% CAP on LEOFF 1 service pensions. We testified in opposition of HB 2914 and HB 2416 when these bills were being considered by the House Appropriation Committee during the 2004 Legislative Session. It would be inappropriate to remove the CAP unless the full contributions as delineated in the statute are restored. This would include retroactive contributions as well.

We see this as a selfish request from a small group who are now benefiting from the contribution holiday and earning additional service credit without making a contribution. These same members have received a 6% increase in their take home pay for the last four years while earning service credit of 2% per year or 8% pension. Six percent of an annual salary of $80,000 equals $4,800 per year or $19,200.00 for the four-year period. Eliminating the CAP would extend this existing inequity even further.

We feel it would be inappropriate for the Legislature to grant an additional benefit to a small group after the majority of the members in the plan have retired and especially when it's being reported by the Actuary that the Fund could have an un-funded liability in 2011.

We also feel that there are some existing inequities as addressed in the letter to the Committee from Senator Morton that should be corrected before creating new benefits.

We have not taken a position on the problem outlined by Senator Morton at this time but we are very sympathetic to the women in this situation, especially when this problem was resolved for a select small group of women in ESB 6380.

Sincerely,

R.C. Warbrouck

Richard C. Warbrouck

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November 5, 2004

Senator Karen Fraser
Select Committee on Pension Policy
PO Box 40422
Olympia, WA 98504-0422

Re: LEOFF Plan 1 Benefit Cap

Dear Senator Fraser:

I am writing to you on behalf of the Retired Firefighters of Washington (RFFOW). RFFOW is aware that the Executive Committee of the Select Committee on Pension Policy has placed an item regarding a LEOFF Plan 1 Benefit Cap on its agenda for November 9, 2004. RFFOW opposes lifting the benefit cap for LEOFF Plan 1 retirees, particularly given the contribution holiday employers and members have enjoyed since June 30, 2000.

As the Committee knows, there have been a number of previous efforts to address the present 60% cap on service retirement benefit for LEOFF Plan 1 law enforcement officers and firefighters. HB 2416 (2004) proposed to increase that cap from 60% to 70%. HB 2914 (2004) proposed to delete the cap entirely. RFFOW believes various legislators will offer legislation to alter the cap in the 2005 session of the Legislature.

The most glaring flaw in such proposals is their significant impact on the funding of LEOFF Plan 1. The Committee has been briefed by the State Actuary's office on whether a surplus or deficit exists in LEOFF Plan 1. To some extent, this calculation depends on whether the value of the LEOFF Plan 1 assets are determined on the basis of market or actuarial value. As the briefing from the Office of State Actuary on May 12, 2004 indicated, as of September 30, 2002, there was a $278 million deficit in LEOFF Plan 1 funds if the funds are valued on the basis of their market value. If the funds are valued on the basis of their actuarial value, the Actuary concluded that there could be a surplus of as much as $757 million as of September 30, 2002. However, even under the rosier actuarial value of the LEOFF Plan 1 funds, the Actuary concluded that the surplus will disappear and employer/member contributions must resume for the 2011-2013 biennium. The Actuary has recently opined that the LEOFF Plan 1 system may be a deficit position as early as 2008.

Given this uncertainty about the value of the LEOFF Plan 1 funds, the absence of employer/member contributions since June 30, 2000, and the impact of removal of the benefit cap, the enactment of legislation removing the cap for the LEOFF Plan 1 retirement benefits is extremely unwise.

RFFOW also believes that the removal of the benefit cap does not constitute good public policy. The LEOFF Plan 1 members who are likely to gain from the removal of the 60% cap on service pensions are probably serving in administrative positions. These individuals have had the benefit of the contribution holiday since June 30, 2000, a substantial financial benefit as they have not been required to contribute 6% of present salary annually to LEOFF Plan 1 since that date. Moreover, many of these individuals are receiving compensation for administrative work, as opposed to active police or fire work. Administrators tend to receive higher pay so that the removal of the cap will cost the system more.

The removal of the cap will offer a tempting target for abuse. Individuals could return to duty from disability status to substantially increase their pension. In Tacoma, an assistant chief of police returned to duty after 10 years of receiving disability payments. This individual worked a single day and then retired on a service pension. He gained two percent for each of the ten years he was on disability, and retired, not at the assistant chief's salary when he became disabled, but at the current assistant chief's salary.

In summary, RFFOW asks the Committee to carefully assess any proposed legislation to alter the cap on service retirements under LEOFF Plan 1. At a minimum, the Committee should receive the latest information from the Office of State Actuary regarding the present surplus/deficit in LEOFF Plan 1. The Committee should also have the best estimate from the Actuary regarding the fiscal impact of any alteration of the cap for service retirement benefits under LEOFF Plan 1.

RFFOW will continue to oppose legislation altering the service retirement benefit cap so long as the contribution holiday persists, and other more pressing needs for reform in the LEOFF Plan 1 benefit structure remain.

If RFFOW can provide any additional information to the Committee regarding these matters, please do not hesitate to contact Richard C. Warbrouck or me.

Very truly yours,

Philip A. Talmadge

PAT:gab

cc: Richard C. Warbrouck
Executive Committee members
Matt Smith

AN ACT Relating to removing the cap on retirement benefits of members of the law enforcement officers' and fire fighters' retirement system plan 1; and amending RCW 41.26.100.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

Sec. 1. RCW 41.26.100 and 1991 c 343 s 16 are each amended to read as follows:

A member upon retirement for service shall receive a monthly retirement allowance computed according to his or her completed creditable service credit years of service as follows: Five years but under ten years, one-twelfth of one percent of his or her final average salary for each month of service; ten years but under twenty years, one-twelfth of one and one-half percent of his or her final average salary for each month of service; and twenty years and over one-twelfth of two percent of his or her final average salary for each month of service: PROVIDED, That the recipient of a retirement allowance who shall return to service as a law enforcement officer or fire fighter shall be considered to have terminated his or her retirement status and he or she shall immediately become a member of the retirement system with the status of membership he or she had as of the date of retirement. Retirement benefits shall be suspended during the period of his or her return to service and he or she shall make contributions and receive service credit. Such a member shall have the right to again retire at any time and his or her retirement allowance shall be recomputed, and paid, based upon additional service rendered and any change in final average salary((~~: PROVIDED FURTHER, That no retirement allowance paid pursuant to this section shall exceed sixty percent of final average salary, except as such allowance may be increased by virtue of RCW 41.26.240, as now or hereafter amended~~)).

--- END ---

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	**035**	**11/22/04**	**Z-0183.1/Z-0184.1**

SUMMARY OF BILL:

This bill impacts the Law Enforcement Officers' and Fire Fighters' Retirement System Plan 1 (LEOFF 1) by removing the provision that limits the retirement allowance for those who became members on or after February 19, 1974 to 60% of their final average salary.

Effective Date: 90 days after session

CURRENT SITUATION:

Currently, the maximum retirement allowance for a member of LEOFF 1 who became a member on or after February 19, 1974 is 60% of their final average salary. Those who became members before February 19, 1974 have no such limit on their retirement allowance.

MEMBERS IMPACTED:

We estimate that 529 active members hired on or after 2/19/1974 out of the total 991 active members of this plan could be affected by this bill. Additional members could be affected if they returned to work and earn over 30 years of service.

Each year of additional service credit beyond 30 years would result in an increase of about $120 in monthly pension payments per person (based on a current annual salary of $71,924).

ASSUMPTIONS:

We assumed that half of the future disabled retirees with at least 34 years of service will elect the proposed service retirement benefit (68% of pay before-tax) in lieu of the 50% of the pay tax-free disability benefit (maximum of 60% with 2 eligible dependents). We also assumed that this proposed benefit change would alter future service retirement behavior in the plan. We subtracted 0.01 from the retirement rates from age 50 to 54, and subtracted 0.02 from the rates from age 55 to 59. The impact of the disability and retirement assumption change is reflected in the cost of this proposal.

FISCAL IMPACT:

Description:

There is no immediate fiscal impact while the plan remains in a surplus or fully funded position. The current plan is projected to remain fully funded because the market value of assets exceeds the liabilities by $39 million (at 9/30/2003). This proposal would reduce the surplus, but as long as a surplus remains on a market value basis, we would not project the plan to emerge from full funding under current long-term assumptions. However, if the plan experiences short-term actuarial losses, the plan would be more likely to emerge from full funding as a result of the proposed benefit increase. Also, if the plan does come out of full funding, the plan would be projected to resume funding earlier and at a higher rate.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

Law Enforcement Officers' and Police and Fire Fighters Retirement System:

(Dollars in Millions)	**Current**	**Increase**	**Total**
Actuarial Present Value of Projected Benefits (The Value of the Total Commitment to all Current Members)	$4,342	$23	$4,365
Unfunded Actuarial Accrued Liability (The Portion of the Plan 1 Liability that is Amortized at 2024)	($462)	$23	($439)
Unfunded Liability (PBO) (The Value of the Total Commitment to all Current Members Attributable to Past Service)	($521)	$16	($505)

Increase in Contribution Rates: (Effective 9/1/2005)

Employee	0.00%
Employer State	0.00%

Fiscal Budget Determinations:

There is no projected increase in funding expenditures.

State Actuary's Comments:

We have projected that the cost of this bill would draw down a portion of the plan's current surplus, but would not increase the plan's future funding requirements. This projection reflects the future recognition of prior asset gains and losses not yet fully recognized under the asset smoothing method and reflects the cost of this proposed plan change. The plan's actual funded status will vary depending on the plan's actual experience and could easily be different than projected over the short-term.

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Law Enforcement Officers' and Fire Fighters' Retirement System.

2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This fiscal note is intended for use only during the 2005 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Unfunded Actuarial Accrued Liability (UAAL): The cost of Plan 1 is divided into two pieces:
- The Normal Cost portion is paid over the working lifetime of the Plan 1 active members. The remaining cost is called the UAAL.
- The UAAL is paid for by employers as a percent of the salaries of all Plan 1, 2 and 3 members until the year 2024.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.